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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1964

No. 46

PEOPLE OF STATE OF CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,
*Petitioners*

v.

LO-VACA GATHERING COMPANY, HOUSTON PIPE LINE COMPANY, EL PASO NATURAL GAS COMPANY,
*Respondents*

No. 47

SOUTHERN CALIFORNIA GAS COMPANY AND SOUTHERN COUNTIES GAS COMPANY OF CALIFORNIA, *Petitioners*

v.

LO-VACA GATHERING COMPANY, HOUSTON PIPE LINE COMPANY, EL PASO NATURAL GAS COMPANY,
*Respondents*

No. 57

FEDERAL POWER COMMISSION, *Petitioner*

v.

LO-VACA GATHERING COMPANY, HOUSTON PIPE LINE COMPANY, EL PASO NATURAL GAS COMPANY,
*Respondents*

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**On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit**

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## JOINT BRIEF FOR RESPONDENTS

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Come now Lo-Vaca Gathering Company (Lo-Vaca), Houston Pipe Line Company (Houston), and El Paso Natural Gas Company (El Paso). Respondents herein and file this Joint Brief in Cases Nos. 46, 47, and 57.

## OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit is reported at 323 F.2d 190 (5th Cir. 1963). It is set forth in the Transcript of Record herein on pages 365-376. The order of the Court below denying petitions for rehearing and the Commission's motion for rehearing *en banc* is set forth in the Transcript of Record herein on pages 377-379. The opinion and orders of the Commission (R. 1100-1113, 1184-1185) are reported at 26 F.P.C. 606 and 840 (1961).

## JURISDICTION

The jurisdictional requisites are adequately set forth in Petitioners' briefs.

## QUESTION PRESENTED

Is a separately identifiable sale of natural gas, restricting use for the purchaser's own consumption or for consumption in intrastate commerce, converted into a sale in interstate commerce for resale by reason of commingling by the purchaser with other supplies to be resold in interstate commerce despite operation of buyer's pipeline system enabling proportional separation from the mixture of restricted-use volumes at designated points of consumption?

## STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act are set forth in the appendix to this brief.

## STATEMENT

The Court below reversed a Commission decision which held that proposed sales by Lo-Vaca and Houston would be subject to its jurisdiction under Section

1(b) of the Natural Gas Act. In reaching its conclusion, the Court followed the consistent rationale of all other cases which have dealt with the issue here involved, holding that a separately identifiable sale of natural gas for consumption by the purchaser or for consumption in intrastate commerce is not changed into a sale for resale in interstate commerce because of commingling by the purchaser with other supplies to be resold in interstate commerce.

The evidence shows that the Lo-Vaca and Houston transactions precisely fit the rationale announced by this Court in *United States* v. *P. U. C. of California*, 345 U.S. 295 (1953) and applied in *City of Hastings* v. *F.P.C.*, 221 F.2d 31 (D.C. Cir. 1954); *North Dakota* v. *F.P.C.*, 247 F.2d 173 (8th Cir. 1957), and *Amerada Petroleum Corp.* v. *F.P.C.*, 334 F.2d 404 (8th Cir. 1964). Their transactions, which restricted the use of the gas by El Paso either for its own consumption or for consumption in intrastate commerce, were separate in all respects from any jurisdictional sales. Faithful to the earlier opinions, Lo-Vaca and Houston demonstrated the separate identities of their restricted-use transactions through proof of separate negotiations, separate contracts, separate metering, separate reserves, separate billing, and separate delivery points, (R. 21-26, 35, 64-65, 107, 216, 257, 821-845, 416-459).

**The Lo-Vaca Transaction**

Pursuant to a contract dated March 15, 1960, Lo-Vaca agreed to sell to El Paso 50,000 Mcf of natural gas per day for delivery to El Paso's affiliate, El Paso Gas Supply Company, at the Coquat Compressor Station near Three Rivers in Live Oak County, Texas. This contract, which we shall term Lo-Vaca's re-

stricted-use contract, expressly restricts the use of the gas by El Paso as follows (R. 842):

> "All of the gas to be purchased by El Paso from Gatherer [Lo-Vaca] under this agreement shall be used by El Paso solely as fuel in El Paso's compressors, treating plants, boilers, camps and other facilities located outside the State of Texas. It is understood, however, that said gas will be commingled with other gas being transported in El Paso's pipe line system."

On May 16, 1960, Lo-Vaca and El Paso entered into a second contract providing for the sale of another 50,000 Mcf per day.[1] This contract also provided for delivery at the Coquat Station. It did not, however, contain any restriction as to use by El Paso. This unrestricted contract is not directly involved here. However, reference to this transaction, when considering the pertinent elements of the restricted-use sale, will demonstrate how effectively Lo-Vaca has maintained the separated identity of the restricted-use sale and has met the requirements of the court decisions.

In *United States* v. *P.U.C. of California*, 345 U.S. 295 (1953), this Court signaled the importance in determining Commission jurisdiction over a sale in one state for direct consumption by the purchaser in another state, when commingling by the purchaser is involved, by stating (345 U.S. at 318):

> "It may be that as an engineering proposition, accurate measurement of the volume resold and the volume directly consumed by the two parties is possible for each billing period. But there is no record evidence of separate rates, separate negotiations, separate contracts or separate rate regula-

[1] Later, this contract was amended to provide for delivery of 80,000 Mcf of natural gas per day (R. 490-491).

> tion by official bodies, in short that the 'sales' themselves were separate, and it is in these terms that the Act would require us to fix the limits of the jurisdictional grant." (Footnote omitted.)

Lo-Vaca went beyond this indicated requirement to assure that its restricted-use transaction would be entirely separate from the unrestricted transaction or any other sale to El Paso. Thus, many aspects of the restricted-use transation illustrate its separate nature. Separate reserves under contract with producers in the Texas Gulf Coast Area are dedicated to be used solely in satisfaction of the restricted-use sale (R. 25-26, 64-65, 216, 875). The delivery point and the metering of the restricted-use gas at Coquat Station will be separate from the non-restricted gas or from Houston's gas which would also be delivered at Coquat Station (R. 35, 257). This separate metering will assure accurate measurement of the restricted-use volumes prior to commingling in El Paso's facilities.

As a further demonstration of the separate nature of the restricted-use transaction the record shows that negotiations for this sale were entirely separate from the negotiations leading up to the unrestricted sale (R. 25). Thus, Lo-Vaca and El Paso began negotiations for the restricted-use gas in February, 1960, and executed their separate contract in March 15, 1960. Negotiations on the unrestricted contract did not begin until about the time the restricted-use contract was executed and final agreement was not reached until May 16, 1960 (R. 21-25). Of course, billing will be made separately for gas sold under each contract (R. 835, 868).

On June 1, 1960, Lo-Vaca filed an application for a certificate of public convenience and necessity request-

ing authority to *gather and deliver* to El Paso the gas to be sold under the restricted-use transaction. Lo-Vaca also requested authority to *gather and sell* the gas to be sold under the unrestricted contract. Lo-Vaca sought authority to transport the restricted use gas because such transportation would be in interstate commerce. However, since the restricted-use sale would be a direct sale for El Paso's own use, as distinguished from a sale in interstate commerce for resale, no authorization to make that sale was requested (R. 814-815).

**The Houston Transaction**

Houston operates an intrastate pipeline system entirely within the State of Texas (R. 104-106, 415). It buys gas from numerous producers in the Texas Gulf Coast area and transports and sells the gas both to city-gate customers and directly to industries (R. 104). It is of particular significance here that many of Houston's gas purchase contracts contain cancellation clauses which require Houston to give notice if it proposes to resell the gas in interstate commerce (R. 109-111, 459). The producers have the right to cancel their contracts and terminate deliveries rather than permit their sales to become sales for resale in interstate commerce (R. 459). These cancellation clauses in the producer contracts are an essential factor in Houston's ability to maintain adequate supplies to serve its intrastate customers in Texas, for many producers will not sell their gas without such a commitment (R. 179).

This background forms the context for Houston's restricted-use sale to El Paso. By a contract dated July 19, 1960, Houston agreed to sell to El Paso 70,000

Mcf of natural gas per day (R. 416-458). Delivery would be made to El Paso Gas Supply Company at the Coquat Station (R. 107, 415). As reflected in the terms of the contract, the parties agreed that El Paso would restrict the use of the Houston volumes to consumption wholly within the State of Texas (R. 421). El Paso would use this gas primarily in its own facilities and a small portion would be consumed in Phillips Petroleum Company's Goldsmith Plant located in Ector County, Texas (R. 421). The contract expressly recognized that construction of separate facilities to transport Houston's gas to the various points of use would be unnecessarily duplicative and economically prohibitive (R. 421). Thus, it provided that the Houston gas could be commingled with other gas in El Paso's system (R. 421).

However, El Paso is obligated to operate its system in Texas so that (R. 422):

> ". . . all components of El Paso's plant consuming fuel gas hereunder shall physically be located on its system of pipe lines and laterals within the state of Texas through which the flow of gas, although commingled with other gas, shall at all times be continuous and downsteam from the originating delivery point defined hereunder. A sufficient volume of the commingled stream of gas shall by said physical connections reach and pass into components of El Paso's plant located in Texas which consume in the aggregate a volume of gas as fuel equal to or greater than the volume of gas contributed into the commingled stream at Three Rivers by Houston. El Paso agrees to retain for a period of six (6) years and on demand will supply meter reading charts taken from meters at such points as may be necessary to enable proof to be made of the foregoing described continuous flow of gas."

The record shows that El Paso can and will operate its system in compliance with its contract obligation (R. 160-162, 358, 486-489).

Because of the uncertainty arising out of the producers' right to cancel their supply contracts, Houston, on December 27, 1960, filed a Petition for Declaratory Order seeking a ruling from the Commission as to the jurisdictional status of its proposed restricted-use sale (R. 907-927).

**El Paso's Operations**

El Paso presently operates a natural gas pipeline system extending from gas fields in western Texas to the Arizona-California border where it interconnects with facilities of pipeline companies operating within the State of California (R. 494). It makes numerous sales in the States of Texas, New Mexico, and Arizona as well as delivering its major load at the California border for consumption within that State (R. 485, 489, 494). Furthermore, it has large requirements of its own for natural gas for use in compressor stations, treating plants, boilers, and camps (R. 486, 487).

In order to obtain the supplies from Lo-Vaca and Houston, El Paso Gas Supply Company proposes in Docket No. CP60-101 to construct and operate a 30-inch transmission main from Three Rivers in Live Oak County, Texas, to El Paso's Sonora Gasoline Plant in Sutton County, Texas (R. 494).

Additionally, in order to assure operation of its system in the manner required by the restricted-use contracts with Lo-Vaca and Houston, El Paso will construct numerous facilities at a total cost of approximately $253,000 (R. 1105). Furthermore, it proposes

to construct a new 16-inch pipeline extending approximately 211 miles from its Keystone Compressor Station to El Paso, Texas, all within the State of Texas.[2] This facility would be used, in part, to carry Houston's restricted-use gas to points of consumption in Culberson and Hudspeth Counties, Texas, without the injection of any out-of-state gas and without having the Houston gas leave the State (R. 485).

After separate metering and delivery, the supplies delivered by Lo-Vaca under both of its contracts and by Houston will be commingled at the Coquat Station in the Supply Company's facilities (R. 35, 257, 139-140, 485). The commingled stream will be transported northwesterly to El Paso's system at the Somora Plant in Sutton County, Texas (R. 140, 485). At that point the Lo-Vaca and Houston gas will be further commingled with other El Paso supplies also originating in Texas (R. 140, 485).

However, from the common stream El Paso will, at all times, utilize for fuel for its plants in Texas and for the Phillips Goldsmith Plant in Texas an amount in excess of the amount purchased from Houston (R. 128, 343). At all times, also, El Paso will consume from the commingled stream in its plants outside Texas an amount in excess of the amount purchased under the Lo-Vaca restricted-use contract (R. 486-487). Fuel uses at all of the plants will be separately metered to assure accurate delivery of volumes at least equal to

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[2] El Paso requested certificate authorization for this line in Docket No. G-18616 which was pending at the time of the Commission's decision below. Although the application in Docket No. G-18616 has been subsequently withdrawn without prejudice, it is assumed for the purposes of the Commission's decision that the facilities would be constructed (R. 1105). (See F.P.C. Br. p. 9).

those purchased under the restricted-use contracts (R. 343). El Paso will, at all times, regulate its takes from Lo-Vaca and Houston to assure that its purchases from neither exceeds the quantities it consumes in the manner outlined above (159, 266-267, 272, 307, 488, 489).

By proportional separation of the restricted-use volumes from the commingled stream at the designated points of consumption, made possible by El Paso's operation of its system facilities, the purpose of the sales will be effected.

Despite this evidence which shows that the Lo-Vaca and Houston restricted-use transactions are entirely separate from any jurisdictional transactions and despite evidence of the operations of El Paso's system demonstrating the manner in which the volumes of restricted-use gas will reach their intended points of consumption, the Commission held both sales to be sales in interstate commerce for resale.

The Commission held, in a complete reversal of its position in earlier cases, that commingling did alter the nature of the Lo-Vaca and Houston sales (R. 1100-1113). It claimed that the presence of molecules of the gas delivered to El Paso by Lo-Vaca and Houston at destinations where El Paso makes resales would be the controlling factor (R. 1110-1111). Reduced to its essentials, the Commission's conclusion is simply that *all* sales, regardless of the separateness of transactions, into a commingled stream are sales in interstate for resale, if a portion of the commingled stream is resold in interstate commerce (R. 1110, 1185).

In reaching this result the Commission ignores both the court-approved separability of transactions test set forth in *United States* v. *P.U.C. of California*, 345

U.S. 295, 318 (1953) (*infra*, pp. 18-20) and the consequences of the fungible nature of natural gas which permits proportional separation by volume (*infra*, pp. 28-35).

The Court below, in reversing the Commission, held that commingling of gas does not destroy the separate nature of the restricted-use transactions. Importantly also, the decision below held that since gas is a fungible commodity the parties can effect proportional separation by volume, a practice which has been recognized by the courts and which is a common practice in transactions involving other fungible commodities (*infra*, pp. 32-35).

## SUMMARY OF ARGUMENT

Lo-Vaca and Houston propose to make sales to El Paso of Texas-produced gas pursuant to transactions which restrict the use of Lo-Vaca's gas to El Paso's own consumption in New Mexico and Arizona and restrict use of Houston's gas to consumption within the State of Texas (R. 422-842). Lo-Vaca and Houston have carefully tailored their restricted-use transactions so that each is essentially separate from any other transaction and neither involves the sale of any gas for resale in interstate commerce. (Transcript of Record, p. 368).

Lo-Vaca and Houston realized that the only practical course would be for El Paso to commingle the restricted-use volumes with other volumes in its pipeline system (R. 422, 842). Since Lo-Vaca and Houston are selling a fungible commodity, physical commingling of the molecules of gas delivered under their restricted-use contracts with other gas in El Paso's system will have no effect upon their separate transactions. Of course, El Paso will operate its sys-

tem in accordance with its contract, at all times, so that by proportional separation at the points of restricted use, it will always utilize volumes equal to or in excess of the volumes which it purchases pursuant to the restricted-use sales. By this means of physical operation El Paso will assure that no volumes purchased under either of the restricted-use sales will be resold or consumed in violation of its contractual commitment (R. 358, 486, 487).

In ruling upon facts indistinguishable from these, the courts have consistently held that physical commingling by the purchaser does not convert a separate nonjurisdictional sale into a sale for resale in interstate commerce. *United States* v. *P.U.C. of California*, 345 U.S. 295 (1953); *City of Hastings* v. *F.P.C.*, 221 F.2d 31 (D.C. Cir. 1954) *cert. denied*, 345 U.S. 420 (1955); *North Dakota* v. *F.P.C.*, 247 F.2d 173 (8th Cir. 1957); *Amerada Petroleum Corp.* v. *F.P.C.*, 334 F.2d 404 (8th Cir. 1964). These cases hold that parties may effect proportional separation of their volumes from the commingled stream and their separate restricted-use transactions do not become subject to Commission jurisdiction. Such a rule gives full effect to the jurisdictional grant of Section 1(b) of the Natural Gas Act while at the same time assuring that Commission regulation is not imposed upon any separate transactions which do not involve sales in interstate commerce for resale. *Panhandle Eastern Pipe Line Co.* v. *P.S.C. of Indiana*, 332 U.S. 507 (1947); *United States* v. *P.U.C. of California*, 345 U.S. 295 (1953).

Significantly, in the daily administration of the Natural Gas Act the Commission, itself, recognizes the reality of proportional separation by volume and an

important segment of the business of interstate transportation of natural gas is dependent upon this fundamental consequence of fungibility. Thus, substantial volumes are transported daily, with Commission approval, where gas is injected into the commingled stream for redelivery, by volume, at another point closer to markets. *F.P.C.* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961) (see, *infra*, pp. 28-32; Appendix pp. 4a-7a).

Moreover, proportional separation by volume makes sound economic sense, for in dealing with natural gas or any other fungible commodity any decision negating such a rule would require resort to elaborate and expensive alternatives or totally discourage many commercial transactions which are plainly in the public interest. *Cf. Munn* v. *Illinois*, 94 U.S. 113 (1876); *Federal Tender Board No. 1* v. *Haynes Oil Corporation*, 80 F.2d 468 (5th Cir. 1935); *Central States Corp.* v. *Luther*, 215 F.2d 38 (10th Cir. 1954) *cert. denied*, 348 U.S. 951 (1955).

Petitioners contend that these long-standing legal and business principles should not apply since by reason of commingling some molecules of the gas delivered by Lo-Vaca and Houston may physically reach points of consumption in California. Petitioners, of course, do not deny that if Respondents were to construct entirely separate facilities from the Coquat Station to the points of restricted use, Commission jurisdiction over the restricted-use sales could not be asserted. Neither do they contend that Lo-Vaca and Houston have not successfully maintained their restricted-use transactions completely separate from any other transaction pursuant to which El Paso buys or sells gas. Further, there is no contention that Lo-Vaca, Houston,

and El Paso will not conduct their operations to make the proportional separation of the restricted-use volumes possible at all times.

Thus, Petitioners are reduced to a contention that the court-approved rationale, which gives effect to a standard commercial practice, should be reversed. They argue, in effect, that El Paso does not purchase a stated volume of gas, a fungible commodity, but that El Paso purchases specific molecules whose separate physical identity should be controlling.

This position represents a complete departure from the position the Commission has taken prior to the Lo-Vaca and Houston proceedings and is entirely inconsistent with its treatment in analogous transportation cases.

Petitioner's position simply cannot be reconciled with the rationale of *United States* v. *P.U.C. of California*, 345 U.S. 295, 318 (1953) nor the holdings in *City of Hastings* v. *F.P.C.*, 221 F.2d 31 (D.C. Cir. 1954); *North Dakota* v. *F.P.C.*, 247 F.2d 173 (8th Cir. 1957), and *Amerada Petroleum Corp.* v. *F.P.C.*, 334 F.2d 404 (8th Cir. 1964). And reliance upon language taken out of context from *Connecticut Light & Power Co.* v. *F.P.C.*, 324 U.S. 515, 529 (1945) is misplaced. For that decision makes it plain that Congress did not make Commission authority coextensive with the scope of Congressional power over interstate commerce. Instead, the Act restricts Commission authority over sales to sales in interstate commerce for resale—a legal limitation, not an engineering test.

Other cases cited by Petitioners are likewise not in point. Thus, *Pennsylvania Water & Power Co.* v. *F.P.C.*, 343 U.S. 414 (1952) and *F.P.C.* v. *Southern*

*California Edison Co.*, involved admitted sales for resale under which some out-of-state energy was sold. Proportional separation by volume and the separability of transactions test were not involved. Similarly, cases cited by Petitioners relating to the scope of interstate commerce such as *Deep South Oil Co.* v. *F.P.C.*, 247 F.2d 882 (5th Cir. 1957) and *Interstate Natural Gas Co.* v. *F.P.C.*, 331 U.S. 682 (1947) are inapposite. And since Lo-Vaca and Houston intend to make restricted-use sales and the parties will conduct their operations so that their intentions are effectuated, cases involving an expressed intent contrary to the real purpose of the parties are of no value here. See, *Baltimore & O.S.W.R. Co.* v. *Settle*, 260 U.S. 166 (1922).

Finally, the decision below will not open a regulatory gap which the Natural Gas Act intended to close. The line of the statute, which was drafted in precise terms of the regulatory gap which existed prior to passage of the Act, cut "sharply and cleanly" between sales for resale in interstate commerce which were beyond state power and direct sales for consumptive uses in interstate commerce and sales in intrastate commerce which were subject to state power. *Panhandle Eastern Pipe Line Co.* v. *P.S.C. of Indiana*, 332 U.S. 507, 517 (1947); *F.P.C.* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964). Commission jurisdiction does not arise, as contended by Petitioners, because they believe that the State of Texas has no interest in regulating sales to El Paso for its own consumption or for consumption in Texas. For the test of the Act is not a case-by-case balancing of national versus local interest.

Furthermore, under Section 7 of the Act the Commission may regulate many aspects of the proposals now before it including certification of producer sales to Lo-Vaca, and the construction and operation of facilities by Lo-Vaca and El Paso. Such authority assures federal regulation of the transactions in the manner prescribed by the Natural Gas Act.

## ARGUMENT

### I.

### THE COURT BELOW CORRECTLY INTERPRETED APPLICABLE LAW.

The starting point for determination of Commission jurisdiction over the Lo-Vaca and Houston restricted-use sales necessarily is Section 1(b) of the Natural Gas Act which provides, in pertinent part, as follows:

> "The provisions of this act shall apply to * * * the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, * * * but shall not apply to any other * * * sale of natural gas . . . ." [52 Stat. 821 (1938; 15 U.S.C. § 717(b)]

This statutory limitation of Commission jurisdiction has been definitively interpreted in *Panhandle Eastern Pipe Line Co.* v. *P.S.C of Indiana*, 332 U.S. 507 (1947) where this Court held (332 U.S. at 517):

> "The line of the statute was thus clear and complete. It cut sharply and cleanly between sales for resale [in interstate commerce] and direct sales for consumptive uses. No exceptions were made in either category for particular uses, quantities or otherwise. And the line drawn was that one at which the decisions had arrived in distributing regulatory power before the Act was passed."

Thus, if, as the Court below found, the Lo-Vaca sale is a direct sale for El Paso's consumption and Houston's sale is not in interstate commerce, the restricted-use sales fall on the nonjurisdictional side of the statutory line which grants to the Commission jurisdiction over only one kind of sale—a sale in interstate commerce for resale.

Application of Section 1(b) in the context of these proceedings is highlighted by the lower Court's observation that if El Paso were to construct separate facilities carrying only the restricted-use gas to the designated points of consumption, unquestionably the sales would not be jurisdictional. Lo-Vaca's sale would be a direct sale in interstate commerce for El Paso's own consumption and Houston's sale for consumption in Texas would be in intrastate commerce.

In circumstances such as these, the courts have consistently held that the mere fact of commingling by the purchaser does not convert a separate nonjurisdictional transaction into a jurisdictional sale. *United States* v. *P. U. C. of California*, 345 U.S. 295 (1953); *City of Hastings* v. *F.P.C.*, 221 F.2d 31 (D.C. Cir. 1954) *cert. denied*, 345 U.S. 420 (1955); *North Dakota* v. *F.P.C.*, 247 F.2d 173 (8th Cir. 1957); *Amerada Petroleum Corp.* v. *F.P.C.*, 334 F.2d 404 (8th Cir. 1964). The courts have held, without exception, that if the nonjurisdictional transaction is entirely separate from jurisdictional transactions involving gas in the commingled stream, the parties may effect a proportional separation of their volumes from the commingled stream and their separate restricted-use transactions do not become subject to Commission jurisdiction. This practice corresponds with the Commission's own action in administration of the Natural

Gas Act in other cases involving commingling and proportional separation and gives effect to standard commercial practice in dealing with fungible commodities.[3]

**A. Proportional Separation By Volume and Determination of Jurisdiction By Separability of Transactions Test Conform to Statutory Scheme**

All pertinent cases which have interpreted the scope of the Commission's jurisdiction under Section 1(b) demonstrate that physical commingling by the purchaser is not sufficient in itself to give the Commission jurisdiction over otherwise nonjurisdictional transactions. Also, implicit in these cases is the recognition that parties may effect a proportional separation by volume from the commingled stream for a particular purpose. Thus, the rationale of law is to preserve the consequences of fungibility, and where a separate nonjurisdictional transaction is identifiable Commission jurisdiction is denied.

*United States* v. *P.U.C. of California*, 345 U.S. 295 (1953) sets forth the controlling rationale. There this Court made it clear that physical identification and tracing of a fungible commodity, electricity, is immaterial if the parties have entered into separately identifiable transactions covering the jurisdictional and nonjurisdictional sales. In that proceeding the Public

[3] In its Forty-Second Annual Report for the Fiscal Year ended June 30, 1962, the Commission reported its Lo-Vaca opinion under a heading entitled "New Regulatory Policies" (see, pp. 23-25). Such a classification as a new policy was obviously accurate for the Commission had espoused the separability test in denying jurisdiction in *City of Hastings* v. *F.P.C.*, 221 F. 2d 31 (1954) and *North Dakota* v. *F.P.C.*, 247 F. 2d 173 (1957). See, *infra*, pp. 21-24.

Utilities Commission of California had sought to assert jurisdiction over a sale of electricity by California Electric Company to the U.S. Navy. The sale, under a single contract making no provision as to use, took place in California where delivery was made to the Navy. After receipt, the Navy transmitted the energy across the state border into Nevada where a minor percentage was resold in a housing development, but the major portion was consumed by the Navy itself in its own industrial operations.

Because of the lack of a separately identifiable transaction covering the sale to the Navy for its own use, this Court denied California's jurisdiction over the sale of the portion of the electricity which the Navy consumed in its own installation, stating (345 U.S. at 318):

> "It may be that as an engineering proposition, accurate measurement of the volume resold and the volume directly consumed by the two parties is possible for each billing period. But there is no record evidence of separate rates, separate negotiations, separate contracts or separate rate regulation by official bodies, in short that the 'sales' themselves were separate, and it is in these terms that the Act would require us to fix the limits of the jurisdictional grant." (footnote omitted).

In the absence of evidence showing that the sale to the Navy for its own use was separate from the sale for resale the Court did not decide the question whether the parties could meet the test of separability of transactions. But implicit in its reasoning is the assumption that if such separability were established the direct

sale in California for the Navy's own use in Nevada would not be subject to federal regulation.[4]

Yet, it is obvious, as admitted by the Commission (F.P.C. Br. p. 28), that commingling of the energy for the Navy's own use with the resale energy would necessarily mean that some portion of the energy actually delivered under the nonjurisdictional direct sale contract would be delivered to the housing development for resale, to be replaced by equal portions of energy actually delivered under the resale contract.

Plainly, if molecular identity at points of consumption had been the determining factor, the Court would not have concluded that when commingled energy is involved the determination of jurisdiction "would turn, of course, on whether an *essentially separate transaction* covering the power directly consumed by the purchaser is identifiable." (345 U.S. at 318, emphasis applied.)

Subsequent to the California case, other decisions have held the rationale of "essentially separate transactions" of fungible commodities to be determinative of Commission jurisdiction. Significantly, in the *California* case itself the Court noted that the Commission was then considering the effect of the "separability of transaction test" in *City of Hastings* v.

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[4] Interestingly, California in its brief here argues that if the power company had entered into a separate transaction covering the sale to the Navy for its own use in Nevada, California would have had jurisdiction over such sale taking place within its own borders. (See, Cal. Br. pp. 24, 31) By parity of reasoning it is equally true that the separate transaction involving the sale by Lo-Vaca to El Paso for consumption in other states is not subject to federal regulation but falls within the scope of state power (see, *infra*, pp. 42-46).

*Kansas-Nebraska Natural Gas Co.*, 12 F.P.C. 12 (1953). It was the Commission's denial of jurisdiction in that case on the ground that the parties had entered into a separate contract for the nonjurisdictional sales which was later affirmed in *City of Hastings* v. *F.P.C.*, 221 F.2d 31 (D.C. Cir. 1954).

In the *Hastings* case, Kansas-Nebraska Pipeline Company sold gas to the City of Hastings under two separate contracts. One contract covered gas to be used by the City in its power plant in generating electricity. The other covered gas to be resold to consumers in the City. Delivery was made in one commingled stream at the city gate. After delivery, gas sold under both contracts was transported still in a commingled stream by the City to points of use or resale. The existence of "essentially separate transactions", one involving a direct sale to the City for its own use in the power plant and the other involving the sale for resale, were definitively established by the "entire course of dealings [which] clearly permitted the Commission to find the existence of separate rates, separate billings, separate negotiations, separate contracts, separate allocation of gas and effective separate measurement facilities." (Footnote omitted; *Id.*, at 36.)

If the Commission's newly espoused theory of physical identification and tracing of molecules from points of delivery to points of use had been applied in the *Hastings* case, the direct sale to the City for power plant use would necessarily have been held to be a sale for resale in interstate commerce. For it is undeniable that some of the molecules of the gas delivered by Kansas-Nebraska Pipeline Company at the city gate for use in the City's power plant would, because of

commingling in the City's facilities with resale gas, be delivered to the points of resale. Yet, because of the proportional separation, by volume, of the gas sold under the separate direct-use transaction, the Court held that the power plant sale did not constitute a sale for resale within the meaning of Section 1(b) of the Act. Effectievly, the Court held, as did the Court below (Transcript of Record, p. 372) that the restricted-use gas was *not* resold in interstate commerce.[5] Obviously, identity of molecules of gas sold under each contract and resold at the points of use had no significance.

*North Dakota* v. *F.P.C.*, 247 F.2d 173 (8th Cir. 1957) applied the same controlling rationale. There two producers which gathered gas from many sources sold the gas under four separate contracts to Montana-Dakota Pipeline Company at the outlet of the Tioga Plant in North Dakota. Each producer agreed to sell 16-cent "firm" gas to Montana-Dakota for resale in four communities in North Dakota. The remainder of the gas delivered was to be at 9 cents per Mcf under so-called "dump" gas contracts for interstate use. The dump gas and the firm gas were commingled in Montana-Dakota's line running westerly into Montana.

Only a small proportion of the commingled stream in Montana-Dakota's line could be attributed to the firm intrastate contracts. Some of the molecules of gas delivered to Montana-Dakota at the tailgate of the Tioga Plant for use in North Dakota were, in fact,

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[5] Petitioners claim that the La-Vaca and Houston gas would be resold in California (F.P.C. Br. p. 9; Cal. Br. pp. 18-19; S. Cal. Br. 45). Of course, their argument begs the question. It is in direct conflict with the effective holding of the courts in the *City of Hastings*, *North Dakota*, and *Amerada* cases.

physically delivered into Montana and molecules of gas delivered under the dump gas contracts were physically delivered to the four communities. Yet the holding of the Court, consistent with the rationale of the *California* and *Hastings*, cases was that the gas sold by Amerada and Signal under their firm intrastate contracts was not resold in interstate commerce.[6]

The Court, agreeing with the Commission, found that the "quantities of intrastate gas purchased by Montana-Dakota under the 'firm gas' contracts are easily identifiable and determinable." Because it was dealing with a fungible commodity in which physical identity of specific molecules is immaterial, the Court recognized that the parties sold "quantities" of gas, not specific molecules (247 F.2d at 177). In such circumstances, jurisdiction turned, as this Court had forecast in the *California* case, upon whether the quantities of intrastate "firm gas" were sold under transactions which were essentially separate from

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[6] The total irrelevance of Petitioner's molecular identification theory to this type of situation is emphasized by reference to specific facts in the *North Dakota* case. Thus, during 1956 the two producers, Amerada Petroleum Corporation and Signal Oil and Gas Company delivered a total of approximately 6,867,270 Mcf into the commingled stream at Tioga. Of this amount, 11,120 Mcf was delivered under the firm gas contracts to the four communities in North Dakota. Signal's portion of this firm gas delivered at the Tioga Plant and attributed to use by the four communities was only 1,668 Mcf. Thus, Signal's 1,668 Mcf of firm gas was commingled with 6,865,602 Mcf of gas sold under other contracts, and most of this gas (6,856,150 Mcf) was interstate "dump" gas sold by the two producers. It cannot be denied that, because of commingling, some and perhaps all, of the molecules of Signal's 1,668 Mcf of firm gas delivered to Montana Dakota at the Tioga Plant found their way into Montana.

transactions involving the sale of interstate "dump gas".[7]

Petitioners try vainly to avoid the impact of the rationale in the *California, City of Hastings*, and *North Dakota* cases, by suggesting that they should be distinguished from the facts here because in those cases the gas or electricity for the restricted use came from the same source as that sold without restriction (F.P.C. Br. pp. 27-34; Cal. Br. pp. 22-29). Demonstrably, such a distinction is without merit.

In the *California* and *Hastings* cases, where both the gas or electricity sold under the jurisdictional and nonjurisdictional contracts came from a single seller, the volumes sold under each contract were physically commingled by the purchaser after the sale so that molecules sold under the nonjurisdictional contract

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[7] The rationale of the Court in the *North Dakota* case is well illustrated by the Commission's own statement urging the result reached. (Brief of Respondent, Federal Power Commission, No. 15669, United States Court of Appeals, Eighth Circuit, dated January 1957, p. 10):

> "For those decisions [the *California* and *City of Hastings* cases] make plain that the indistinguishable commingling of jurisdictional and non-jurisdictional gas in delivery is not sufficient in itself to require that sale of both be subjected to F.P.C. jurisdiction. *In every case* where there is commingling, indistinguishably, in a single flow, of some gas (or electricity) delivered in interstate commerce for resale, with other gas (or electricity) not delivered in interstate commerce or not for resale, it is necessary for the Commission to determine 'whether [or not] an essentially separate transaction [for the nonjurisdictional delivery] . . . . is identifiable.' *United States* v. *P.U.C. of California*, 345 U.S. 295, 318. The decisions spell out the principle upon which the Commission here rightly concluded that the transactions embodying the jurisdictional and non-jurisdictional elements, respectively, are separate." (Emphasis supplied.)

would be mixed with the molecules sold under the jurisdictional contract and physically would reach points of resale. Physical commingling requires this result whether there be one "source" or many for the very concept of commingling connotes mixture. Thus, if the controlling consideration, were, as argued by Petitioners, that the existence of molecules delivered under a restricted-use contract at points of unrestricted use converts the restricted-use sale into an unrestricted-use sale, then application of such a theory in the *Hastings* and *Californias* Cases would have required assertion of jurisdiction despite existence of separate transactions.[8]

Nonetheless, Petitioners persist in their contention that the existence of a single source for restricted-use and unrestricted-use volumes enables proportional separation which would not be possible if the commingled stream contained supplies from additional sources (F.P.C. Br. pp. 27-34; Cal. Br. pp. 25-29). Of course, if proportional separation from a commingled stream is possible when the stream contains gas from one seller under two contracts, proportional separation is no less possible if other sellers add to the commingled stream. However, Petitioners' theory fails for yet another reason. The *North Dakota* case, which Petitioners refer to as an example of their one source theory, in fact involved many sources. And even if the several sources are considered to be reduced by commingling in the Tioga Plant there remain at least two sources or sellers. Gas attributed to Signal's sale for resale in North Dakota need not necessarily have been

[8] Respondents recognize, of course, that in the *California* case the lack of separate transactions required assertion of jurisdiction over the single sale covering both the resale energy and the direct sale energy.

delivered under either of Signal's contracts. Because of commingling with Amerada's gas, some of the molecules actually derived from Amerada. Clearly Petitioners' "one source" theory does not even apply in the case from which it is purported to be taken.

The fallacy of Petitioners' argument is emphasized by the sequel to the *North Dakota* case recently decided, *sub nom., Amerada Petroleum Corp.* v. *F.P.C.*, 334 F.2d 404 (8th Cir. 1964). There, Amerada and Signal proposed to sell additional volumes to Montana-Dakota for intrastate use and also to increase the volumes which Montana Dakota would resell in interstate commerce. The producers requested certificates for the sales relating to the interstate contracts but did not request authorization for the sales of additional volumes to be resold in the State of North Dakota. As was true in the *North Dakota* case, the volumes of intrastate gas sold by Amerada and Signal would be commingled in Montana Dakota's pipeline with the interstate gas. One additional feature was added which the Commission seized upon as distinguishing the sequel from its predecessor. This new fact was the injection of additional supplies by other producers into the commingled stream. These new producers sell their gas to Montana-Dakota under unrestricted contracts, their sales being sales for resale in interstate commerce.

The Commission claimed that the addition of these new supplies changed the Amerada and Signal intrastate sales into sales in interstate commerce for resale.

In reversing the Commission, the same Court which had decided the *North Dakota* case held that the addition of a new source of gas into the commingled stream

has no legal significance. The Court pointed out that in the *North Dakota* case all of the gas had not originated from one source but instead had come from several sources. Therefore, the addition of another source in the *Amerada* case could have no new significance.

The Court then penetrated to the core of the Commission's argument by making it clear that the number of sources plays no part in jurisdiction over the sale. Thus, it held (334 F.2d 410-411):

> "The fact remains that the controlling issue is not the point of entry into MDU's pipeline of the destined intra and interstate gas whether both classes of gas are derived from one or several sources. It is the validity of division by contract and volume of interstate sales of gas confessedly subject to federal regulation from asserted non-jurisdictional gas produced and sold in the same state, both transactions remaining unaffected by the fact that common transportation facilities are shared en route to their intended destination. If the commingling of the interstate and intrastate gas in the former case [the *North Dakota* case] did not deprive the state of regulatory jurisdiction, then the mere induction of additional interstate gas from other sources would not have that effect now. Admittedly, if the North Dakota Contract gas [the intrastate gas] was conveyed by separate pipeline the Commission would concede its lack of jurisdiction. We cannot fashion our decision on such an onerous and illogical result that would necessitate the building of a parallel pipeline with its attendant expense, inevitably to be borne by the rate payers, to say nothing of the waste of natural resources during the interim."

**B. Proportional Separation by Volume and Determination of Jurisdiction by Separability of Transactions Test are Standard Criteria Utilized in Administration of Natural Gas Act.**

It is apparent from the foregoing cases that the courts have recognized the standard business practice of proportional separation by volume, the consequence of fungibility, when considering the jurisdictional nature of a sale of natural gas. From this basic premise they have then sought to determine whether the restricted-use sale constitutes a separate transaction relating only to the gas sold for the nonjurisdictional purpose. If this separability test is satisfied, Commission jurisdiction does not attach.

Significantly, this rationale conforms with the regular practice of the Commission itself in its daily administration of the Natural Gas Act. Thus, an important segment of the natural gas industry relies upon these concepts, for in all transportation arrangements where any transportation gas is commingled with gas sold under resale contracts, the validity of proportional separation by volume is assumed.

These transportation arrangements are illustrated by the decision in *F.P.C.* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961). In that case, Transcontinental sought a certificate authorizing the transportation of gas for Consolidated Edison Company from Texas to New York City. Consolidated Edison had entered into gas purchase contracts with several producers and proposed to take delivery in the field. Consolidated Edison would then deliver its gas to Transcontinental under a transportation agreement whereby the interstate pipeline company would carry the gas in its pipeline system to New York City for redelivery to Consolidated Edison.

It is significant that this Court, and the Commission itself, readily recognized that the producers' sales to Consolidated Edison for its own use in another state would not be subject to Commission jurisdiction because they were not sales for resale (365 U.S. at 23-24). At the same time it was contemplated that Consolidated Edison's gas would be commingled in the pipeline with other supplies which were to be resold so that physical identity of the molecules delivered by Consolidated Edison to Transcontinental could not be traced.[9] The basic premise in the Court's determination is inescapable: Consolidated Edison and Transcontinental could effect a proportional separation of transportation volumes under a separately identifiable transportation agreement.[10]

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[9] The transportation gas would, of course, be commingled with supplies from numerous sources, not just one, so that it is obvious that the Commission's "single source" theory is equally as inapplicable to this type of transaction as it is in the case of restricted-use sales. (See, *supra*, pp. 25-27).

[10] In its brief the Commission suggests that the transportation arrangement might be treated as three unrestricted sales—one by the producers to Consolidated Edison, a second by Consolidated Edison to Transcontinental, and finally, a third by Transcontinental back to Consolidated Edison. Aside from the fact that there is no evidence upon which to base such an assumption, it should be sufficient to note that this strained interpretation was not indulged in by the Commission in its opinion in this case, for it expressly recognized the proportional separation effected by transportation arrangements and stated that "It is not our intention by this opinion to disturb such transportation arrangements." (R. 1107).

Plainly, since the interpretation now advanced in the appellate *post hoc* rationalization played no part in the Commission's decision, it cannot now be considered as basis for supporting the decision which the Commission did make. *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168-169 (1962).

In a further attempt to avoid the impact of the *Transcontinental* case, the Commission suggests that jurisdiction over the producers'

Other cases further illustrate the importance of proportional separation by volume in administration of the Act. For the Commission has authorized the construction and initial operation of major interstate pipeline systems which are dependent, in significant part, upon transportation arrangements permitting nonjurisdictional sales at one end of the sysem and proportional separation of transportation volumes at the other end. See, *e.g., Houston Texas Gas & Oil Corp.*, 16 F.P.C., 118 (1956), affirmed *sub nom. Florida Economic Advisory Council* v. *F.P.C.*, 251 F.2d 643 (D.C. Cir. 1957) *cert. denied*, 356 U.S. 959 (1958), where three-fifths of the initial system capacity was dedicated to transportation of gas purchased in Texas by electric power companies in Florida (16 F.P.C. at 121-122). See also, *Trans-Continental Gas Pipe Line Co., Inc.*, 7 F.P.C. 24, 29, 34 (1948).

Although the *Transcontinental* and *Houston Texas Gas & Oil Corp.* cases discussed above are remarkable examples, the Commission regularly approves numerous transportation agreements which are dependent upon the same concept of proportional separation by volume. Thus, many of the major pipeline companies

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sales to Consolidated Edison was not in issue and therefore the Commission did not give consideration to this aspect (F.P.C. Br. p. 21). Such a contention is hardly plausible in view of the fact that a major issue in certification of the transportation service was the effect the producers' prices would have upon other prices in the area (365 U.S. 1, at 23-24). Certainly, unless the Commission had assumed that it had no jurisdiction over the producers' sales there would have been no need for basing denial of the transportation certificate on the ground that the producers' prices might have an adverse effect upon the public interest. The Commission could have directly controlled the producer prices and thereby avoided the question of its indirect power through control of the certificate issued to the pipeline.

have transportation rate schedules on file with the Commission pursuant to which they transport gas for others.[11] The function of these transportation agreements, and the concomitant proportional separation of transportation volumes, finds its origin in the basic needs of the industry. Typically, a company, in many cases a pipeline company, may have a source of gas not closely connected to its system or market. The gas may be brought to its system either through construction of substantial and costly facilities or it may be transported by a pipeline already in the area to some point where the two pipeline systems cross or where the market exists. Obviously, economy dictates the choice of the latter alternative. Obviously, also the same basic fact underlies the negotiation of the Lo-Vaca and Houston restricted-use sales.

But recognition of the legal consequences of fungibility and application of the separability of transactions test has not been limited to transportation arrangements. In addition to the *California, City of Hastings, North Dakota*, and *Amerada* cases discussed above (supra, pp. 18-27) which bear directly upon this issue, the Commission has applied the same rationale in other instances. For example, in *Colorado Interstate Gas Co.*, 19 F.P.C., 1012 (1958) the Commission held that a sale of gas flowing into a commingled stream could be changed from jurisdictional to non-

[11] The Annual Reports (Form 2) filed for natural gas pipeline companies covering operations conducted in the year 1963 show transportation deliveries of approximately 1,552,118,382 Mcf, large amounts of which were transported in commingled streams. There is set forth in the appendix hereto a listing of some of the more significant of the transportation arrangements which do involve commingling and proportional separation.

jurisdictional by the negotiation of a separate transaction covering a sale for consumption by the purchaser (*Id.*, at 1022). Another example is contained in *Shell Oil Co.*, 25 F.P.C., 1316 (1961), decided shortly before this case, in which a sale of gas for direct consumption by the purchasers was held to be nonjurisdictional despite the fact that it would be transported in a commingled stream with other gas destined for resale in interstate commerce (*id.*, at 1322).

Plainly, proportional separation by volume and the separability of transaction test do not comprise exceptions to the Commission's general practice in administration of the Natural Gas Act. On the contrary, they form an integral part of the statutory scheme in which only sales for resale in interstate commerce would be regulated by the Commission, and all other sales, of whatever sort, would remain subject to state power. *Panhandle Eastern Pipe Line Co.* v. *P.S.C. of Indiana*, 332 U.S. 507, 517 (1947).

### C. Proportional Separation by Volume of Fungible Commodities is Standard Business Practice

The practice of the Commission giving effect to proportional separation of commingled volumes of natural gas in transportation cases merely gives due recognition to the standard business practice which prevails wherever commingling of a fungible commodity is involved. As the Court below noted, the "concept of separate identity, by volume, is not new." (Transcript of Record, p. 371). Gas, like oil, grain, coal, or other commodities of the same kind and quality may be mixed so that separate identity of the goods becomes impossible but division can be made of proportional volumes.

Thus, the Court below noted that in the "hot oil" cases it had rejected a contention of the Federal Tender Board which was essentially the same as the molecular identification argument urged by the Commission here (Transcript of Record, p. 371). The fungibility of oil permitted proportional separation by volume of the lawfully produced oil without affecting the contraband oil in the mixture. *Federal Tender Board No. 1* v. *Haynes Oil Corporation*, 80 F.2d 468, 469 (5th Cir. 1935).

Similarly, it has been held that proportional separation of a fungible commodity, oil, is the controlling factor determining whether interstate or intrastate rates apply. *Humble Oil & Refining Co.* v. *Texas & Pacific Railway Co.*, Tex., 289 S.W. 2d 547 (1955).

The concept of fungibility and concomitant proportional separation by volume has been aptly described, as follows [*Gourd* v. *Healy*, 206 N.Y. 423, 99 N.E. 1099 at 1102 (1912)]:

> "* * * Property may be acquired and held in many things which are incapable of more specific designation than a reference to their kind, quality, or other general description. 'Articles of this nature are sold, not by a description which refers to and distinguishes the particular thing, but in quantities, which are ascertained by weight, measure, or count; the constituent parts which make up the mass being undistinguishable from each other by any physical difference in size, shape, texture or quality.' * * *."

The grain cases involve many examples of application or recognition of the consequences of fungibility. Thus, as early as *Munn* v. *Illinois*, 94 U.S. 113 (1876) the Court noted that the practicalities of business operations make it impossible to preserve each owners grain

physically separate. Accordingly, a mode of conducting business was inaugurated whereby grain of like quality was commingled. Owners were issued receipts which were redeemable in kind (*id.*, at 131). See also, *Central States Corp.* v. *Luther*, 215 F.2d 38, 45 (10th Cir. 1954), *cert. denied*, 348 U.S. 951 (1955) (grain); *United States* v. *Amalgamated Sugar Co.*, 72 F.2d 755 (10th Cir. 1934) (sugar); and *Re Wyoming Valley Collieries Co.*, 29 F. Supp. 106 (M.D. Penn. 1939) (coal).

In another recent natural gas case a separate sale was held to have been effected even though the portion separately sold was, at the time of the sale, in a commingled state with other volumes not covered by the transaction. *Mississippi State Tax Commission* v. *Columbia Gulf Transmission Co.*, 161 So. 2d 173 (Miss. 1964).

Of course, the nature of gas as a fungible commodity and the ability to effect proportional separation of volumes underlies the decision in *Peoples Natural Gas Co.* v. *P.S.C. of Pennsylvania*, 270 U.S. 550 (1926) where this Court held (*id.*, at 554-555):

> "As respects the Pennsylvania gas we think it must be held to be in intrastate commerce only. Feeding it into the same pipe lines with the West Virginia gas works no change in this regard. Of course, after the commingling, the two are indistinguishable. But the proportions of both in the mixture are known, and that of either readily may be withdrawn without affecting the transportation or sale of the rest. So for all practical purposes the two are separable, and neither affects the character of the business as to the other. The Supreme Court of the state has found that more than enough Pennsylvania gas goes into the mix-

> ture to meet the requirements of the order, and on this basis has construed the order as leaving the company free to deal in usual course with so much of the mixture as represents the gas from West Virginia. * * * In these circumstances the conclusion is unavoidable, we think, that the order does not interfere with or affect the interstate commerce in which the company is engaged."

Plainly, the Commission's molecular identification theory runs counter to the whole stream of law governing commercial practices involving fungible commodities. On the other hand, the decided cases and the Commission's former practice which still pertains with respect to transportation arrangements are consonant with the general business practice prevalent throughout the gas industry and other industries wherever fungible property is involved.

**D. Lo-Vaca and Houston Sales Meet the Separability of Transactions Test and El Paso Operations Make Proportional Separation by Volume a Practical Reality.**

When the dual principles of separability of transactions and proportional separation by volume are applied to the record facts, it is readily apparent that both Lo-Vaca and Houston propose nonjurisdictional sales and the parties can and will conduct their operations to assure this result.

The separability of the transactions is obvious. Lo-Vaca has dedicated separate reserves for its restricted-use sale (R. 65). Its restricted-use gas will be metered separately from unrestricted gas at separate delivery points (R. 25, 35). The gas sold under the restricted-use sale is the subject of an entirely separate contract which was separately negotiated (R. 821). Billing for

the restricted-use gas will be made separately (R. 835, 863).

Similarly, Houston's transaction for intrastate use will be completely separate from any other sale. The delivery point and metering will be separate from Lo-Vaca's (R. 266). And separate metering at each of the points of intrastate use will preserve the separate identity of volumes (R. 141, 343, 486, 487).

El Paso will continue the separate identification by volume of both the Lo-Vaca and Houston restricted-use gas through metering both at the points of receipt at Coquat Station (R. 266-267) and at the several points of use (R. 343). Moreover, El Paso will, at all times, regulate its takes from Lo-Vaca and Houston to assure that its purchases from neither will exceed the quantities it will consume at the respective points of restricted use (R. 159, 266-267, 272, 307, 486-489). And El Paso will operate its system so that the restricted-use gas can reach the points of restricted use (R. 486-489) thus enabling the proportional separation of the restricted-use volumes. Because of proportional separation from the commingled stream, the Lo-Vaca and Houston sales will not relate to any volumes resold in interstate commerce. Conversely, all volumes resold in interstate commerce by El Paso will relate to gas purchased by El Paso pursuant to unrestricted contracts subject to Commission regulation.[12]

[12] California now appears to contend that El Paso cannot operate its system in the manner which is proposed (Cal. Br. pp. 14-15). Such an argument is belied by the record facts as shown on Exhibit Nos. 7, 8, 9, and 10 (R. 486-489) and the supporting testimony of El Paso's engineering witness. Significantly, the Commission, itself, accepted these facts of El Paso's system operation (R. 1105-1106). Patently, California's newly-advanced contention is wholly unsupported and unsupportable.

Respondents do not propose physically to segregate the restricted-use gas in the commingled stream by means of their contracts. There is no necessity to do so. However, Respondents will keep their restricted-use transactions separate, for determination of jurisdiction turns upon whether essentially separate sales are identifiable. *United States* v. *P.U.C. of California*, 345 U.S. 295, 317-318 (1953). Indeed, under the Natural Gas Act, there is no such thing as "jurisdictional gas." [See, Section 1(b), Section 7(c)]

## II.

### PETITIONERS' POSITION IS UNSUPPORTABLE.

Each of the Petitioners bases its argument for Commission jurisdiction on a contention that, because of commingling, some of the molecules of gas delivered under the restricted-use contracts will be in the commingled stream when it reaches the California border (F.P.C. Br. pp. 12-13; Cal. Br. p. 20; S. Cal. Br. p. 5). Referring to an excerpt from this Court's opinion in *Connecticut Light & Power Co.* v. *F.P.C.*, 324 U.S. 515 (1945), they claim that Commission jurisdiction under the Act extends to all sales into the commingled stream.

Significantly, Petitioners' reliance upon one sentence taken out of context from the *Connecticut* case is wholly misplaced. Instead of holding that the Federal Power Act gives the Commission jurisdiction based upon an "engineering and scientific test," the opinion makes clear that Congress did not adopt such a test. The language from the *Connecticut* case relied upon by Petitioners is placed in proper context in the more complete quotation below, the emphasized portion

being the language relied upon by Petitioners (324 U.S. at 529):

> "This bill came before Congress as prepared by the staff of the Commission, couched largely in the technical language of the electric art. *Federal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental test.* Technology of the business is such that if any part of the supply of electric energy comes from outside of a state it is, or may be, present in every connected distribution facility. Every facility from generator to the appliance for consumption may thus be called one for transmitting such interstate power. By this test the cord from a light plug to a toaster on the breakfast table is a facility for transmission of interstate energy if any part of the load is generated without the state."

From the remainder of the opinion it is clear that what the Court was saying in the *Connecticut* case was that the original draft of the bill sent to Congress intended to give the Commission jurisdiction to follow the flow of electricity, an engineering and scientific test. *But Congress did not accept that version* and attached legal standards of limitation (*Id.*, at 531)[13] One of the limitations which was included in the Act as finally passed and the significant one here, is that Commission jurisdiction over sales is limited to one

[13] The Court in the recent *Amerada* case effectively disposed of this same argument that the *Connecticut* case stood for the proposition that Commission jurisdiction is based upon an engineering test, without legal limitations. Thus, the Court noted, as we have above, that the Commission's argument was taken out of context and that when the *Connecticut* opinion is read in its entirety it is clear that the test which the Commission is now urging was considered but rejected by Congress. *Amerada Petroleum Corp.* v. *F.P.C.*, 334 F. 2d 404, 409-410, note 4 (1964).

type of sale—a sale in interstate commerce for resale. Nowhere in the Act is the Commission given jurisdiction over gas, as such. It is the sale which is subject of regulation. This is fundamental to the separability of transactions test announced in the *California* case where this Court noted that when commingled energy is involved determination of jurisdiction "would turn, of course, on whether an essentially *separate transaction* covering the power directly consumed by the purchaser is identifiable." (345 U.S. at 317-318; emphasis supplied.)

Likewise, reliance upon *Pennsylvania Water & Power Co.* v. *F.P.C.*, 343 U.S. 414 (1952) and *F.P.C.* v. *Southern California Edison Co.*, 376 U.S. 205 (1964) is misplaced in the context of this case. Both of those cases involved sale for resale of energy some of which was produced locally and some of which had out-of-state origin. This Court held in both cases that the sale for resale, since it included energy which had been produced in another state, was subject to Commission jurisdiction. Clearly, there was no assertion of jurisdiction over a separate transaction involving only the sale of energy for a restricted or nonjurisdictional purpose. On the contrary, the lack of such separability resulted in Commission jurisdiction over the entire amount sold under the single contract regardless of its ultimate use.[14]

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[14] An additional distinction between the *Penn. Water* case and the facts of this case should be noted. In *Penn. Water* electricity was produced at several points on an integrated system both in Pennsylvania and Maryland. Depending upon the needs of the system energy produced at the several sources could be switched back and forth instantaneously. Out-of-state energy could thus be present at any time at any point on the integrated electric system. In contrast, gas produced in Texas moves in El Paso's

Similarly, other cases cited by Petitioners are not pertinent for they do not involve either proportional separation of volumes or the separability of transactions test. Thus, *Deep South Oil Co.* v. *F.P.C.*, 247 F.2d 882 (5th Cir. 1957) does not reach the issues involved here for the decision did not touch upon the validity of proportional separation by volume and separability of transactions simply because those issues were not involved.

The cases dealing with the scope of interstate commerce such as *Jersey Central Power & Light Co.* v. *F.P.C.*, 319 U.S. 61 (1943); *Hartford Electric Light Co.* v. *F.P.C.*, 131 F.2d 953 (2d Cir. 1942), *cert.* denied, 319 U.S. 741 (1943); and *Interstate Natural Gas Co.* v. *F.P.C.*, 331 U.S. 682 (1947) are likewise irrelevant. None deal with the issue here presented whether the parties may, through separate nonjurisdictional transactions and by means of a carefully monitored system operation, effect a proportional separation from the commingled stream.

Neither are the several cases dealing with an expressed intention contrary to fact of any assistance to Petitioners' position. Here Lo-Vaca and Houston intend to make restricted-use sales. They do not intend sales for resale in interstate commerce. Indeed, Houston's producers may cancel their supply contracts if Houston makes such a sale. Here, also, because of the proportional separation effected by system operations in accordance with the terms of the contracts,

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system in a constant "downstream" direction to points of consumption. The record shows that no out-of-state gas will be present at any time in El Paso's facilities which transport and consume Houston's gas (R. 149, 160).

the intention of Lo-Vaca and Houston conforms to the fact.

Furthermore, the cases such as *Baltimore & O.S. W.R. Co.* v. *Settle*, 260 U.S. 166 (1922), show that intention may indeed be a factor in determining the nature of a transaction. What these cases hold is that the parties real intention is significant, and any expressed intention at variance with the real intent is not controlling. Thus, in *Baltimore & O.S.W.R. Co.* v. *Settle*, the real intention of the parties was to make a through shipment in interstate commerce. Consequently, interstate rates were held to apply to the entire shipment to the point of final destination. Similarly, in *Superior Oil Co.* v. *Mississippi*, 280 U.S. 390 (1930) the real intention of Superior was to engage in intrastate commerce. Its contractual agreement did not change this intention (*id.* at 394-395).

By contrast, the real intention of Lo-Vaca and Houston here is to make restricted-use sales. Lo-Vaca and Houston have no intention whatever of making sales for resale in interstate commerce. Indeed, as noted above, Houston's supply contracts rule out any such possibility (R. 109-111, 459).

## III.

### THERE IS NO REGULATORY GAP.

Petitioners contend that the result reached by the Court below, even though consistent with other decisions, will result in a regulatory gap not intended by the Natural Gas Act (F.P.C. Br. pp. 22-27; Cal. Br. pp. 31-33). To reach their conclusion, Petitioners find it necessary to depart from the unbroken line of precedents which has defined the so-called regulatory

gap in terms of the limits of state power over transactions in interstate commerce and federal regulation at the time of the passage of the Natural Gas Act. *Panhandle Eastern Pipe Line Co.* v. *P.S.C. of Indiana*, 332 U.S. 507 at 517. Petitioners now ask this Court to scrap the test of the Act and substitute a new test to be applied on a case by case basis in which the Commission and the courts would balance national and local interest in a direct sale in interstate commerce or even a sale in intrastate commerce to a pipeline operating in interstate commerce (F.P.C. Br. p. 24; Cal. Br. p. 31). In short, Petitioners would have Commission power over sales vary depending upon the "interest" of the states to regulate transactions which are admittedly within their *power* to regulate (F.P.C. Br. p. 24). But this Court, as recently as last term, expressly renounced any such test of federal jurisdiction. *F.P.C.* v. *Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964).

The Commission advances a novel theory that it should have the power to regulate the Lo-Vaca and Houston sales because "no State *could be expected* to regulate a sale to an interstate pipeline for ostensible use in the latter's own operations." (F.P.C. Br. 24 emphasis supplied). And it continues, the producing state (here, Texas), "*though perhaps having the power*, would have *little interest* in regulating an item of pipeline cost which would be reflected chiefly in rates paid by customers in other States." (F.P.C. Br. p. 24.)

Notably, the Commission does not base its argument, as indeed it cannot, upon a lack of state power to regulate the sales to El Paso but upon what it assumes to be a lack of interest on the part of Texas in regula-

tory sales.[15] The very manner in which the Commission frames the issue assumes that sales to El Paso for its own use are direct sales (F.P.C. Br. 24). But Section 1(b) limits Commission authority to sales for resale in interstate commerce.

Nonetheless, the Petitioners urge the Court to expand Commission jurisdiction to comprehend sales which are not sales in interstate commerce for resale. The Commission frankly admits existence of state power but contends that the state having the power to regulate the transaction "would have little interest" in doing so. Thus, the Commission bases its assertion of jurisdiction here not upon the statutory distinction between sales in interstate commerce for resale, on the one hand, and all other types of the sales, on the other, but upon its conclusion that the State of Texas has no inclination to regulate.

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[15] It is well established that under Texas law the State of Texas has the power both to fix city rates and to regulate industrial sales. *State* v. *Public Service Corporation of Texas*, 88 S.W. 2d 627 (1935), Tex. Civ. App. error refused; *Railroad Commission* v. *Houston Natural Gas Corp.*, 289 S.W. 2d 559 (1956); *United Gas Corp.* v. *Shepherd Laundries Co.*, 189 S.W. 2d 485 (1945). Vernon's Texas Annotated Statutes 6056-6066. Moreover, the Commission has recently found, in another context, that with regard to Lo-Vaca's existing operations: "(*United Gas Pipe Line Co.* v. *Coastal States Gas Producing Co.*, Docket No. CP64-75, Opinion No. 419, issued February 10, 1964, mimeo. ed., p. 4):

> "* * * [A] certificate of the Texas Railroad Commission has been filed with us in accordance with the provisions of Section 1(c) of the Act to the effect that the rates, services and facilities of Lo-Vaca involved in its sales of natural gas for resale in Texas are subject to its [The Texas Railroad Commission's] regulatory jurisdiction and it is exercising such jurisdiction.'"

Significantly, however, the Commission took no evidence on the issue of national versus local interest and its argument on this point is based only on surmise.

Nowhere in the Act, its legislative history, or Court decisions is there any support for this position. Indeed, exactly the opposite conclusion is commanded. The decision by this Court in *F.P.C.* v. *Southern California Edison Co.*, 376 U.S. 205 (1964) is the most recent of many decisions which reject the contention that Commission authority is to be determined in each case based upon an evaluation of state versus national concern. See, *e.g.*, *Panhandle Eastern Pipe Line Co.* v. *P.S.C. of Indiana*, 332 U.S. 507 (1947); *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co.*, 314 U.S. 498 (1942).

Only a brief resume of applicable law will demonstrate the fallacy of the Commission's position. For the "regulatory gap", which was closed by the Natural Gas Act, extended only to those transactions in interstate commerce which the States were powerless to regulate. *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co.*, 314 U.S. 498 at 507.

Preliminarily, it should be noted the extent of the Commission's authority to regulate transactions in interstate commerce is dependent upon the "gap" in regulation as it existed at the time the Natural Gas Act became law. (*Id.*, at 504). "But prior constitutional decisions, not what [the Courts] have since decided or would decide today, form the measure of the gap which Congress intended to close by this Act." *F.P.C.* v. *East Ohio Gas Co.*, 338 U.S. 464, 472 (1950). Furthermore, the line between state power, on the one hand, and Commission authority, on the other, is sharp and clean allowing for no gray areas to be determined on the basis of state "interest" in regulation. *Panhandle Eastern Pipe Line Co.* v. *P.S.C. of Indiana*, 332 U.S. 507 at 517.

Prior to the passage of the Natural Gas Act this Court had clearly defined the areas of interstate commerce where states could act and the areas where they were forbidden to act. Thus, the line was drawn between direct sales "of whatever sort" for consumption by the purchaser which states had the power to regulate and sales for resale in interstate commerce which were beyond the reach of state power. *Id.*, at 514-515; *F.P.C.* v. *Southern California Edison Co.*, 376 U.S. 205, at 214-215.

As early as *Pennsylvania Gas Co.* v. *Public Service Commission*, 252 U.S. 23 (1920), this Court held that states have power to regulate sales in interstate commerce if such sales are made for direct consumption by the purchaser. On the other hand, *Missouri* v. *Kansas Natural Gas Co.*, 265 U.S. 298 (1924); and *P.U.C. of Rhode Island* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927) made it clear that sales for resale in interstate commerce were beyond the scope of state power. In the absence of any federal legislation to occupy the field where states were powerless to act, there existed a gap in regulation.

Thus, the Natural Gas Act was drafted with precision to grant authority to the Commission to regulate only that portion of interstate commerce which had been held to be beyond state power at time of passage of Natural Gas Act. The legislative history of the Natural Gas Act contains numerous references making plain the intent of Congress.[16]

If any doubt lingered as to the extent of the regulatory gap, it was definitively settled by this Court last

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[16] See, *e.g.*, H. Rep. No. 2651, 74th Cong. 2d Sess. pp. 1-2 (1936); H. Rep. No. 709, 75th Cong. 1st Sess. pp. 1-2 (1937); Sen. Rep. No. 1162, 75th Cong. 1st Sess. pp. 1-2 (1937).

term in *F.P.C.* v. *Southern California Edison Co.*, 376 U.S. 205 (1964). This Court there noted that "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary such case-by-case analysis." (*Id.*, pp. 215-216)[17] This Court reached this conclusion after thorough examination of the case law both prior and subsequent to passage of the Federal Power Act and Natural Gas Act. It noted that the Congress "rather than adopting this flexible approach. . . ." of weighing local and national interest in each sale, had adopted a test developed prior to passage of the Act which had denied state power to regulate sales for resale in interstate commerce but permitted state regulation over direct sales. The direct sale—sale-for-resale distinction written into the Natural Gas Act automatically weighs national and local concern in the manner intended by the Natural Gas Act. *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co.*, 314 U.S. 498, 506-508 (1942).

The decision in the *Southern California Edison* case is, of course, entirely consistent with *Panhandle Eastern Pipe Line Co.* v. *P.S.C. of Indiana*, 332 U.S. 507 (1947) where the Court held that the line of the statute was "clear and complete. It cut sharply and cleanly between sales for resale and direct sales for consumptive uses. *No exceptions were made in either category for particular uses, quantities or otherwise.*" (*Id.*, at 517; emphasis supplied.)

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[17] Interestingly, the Commission itself argued in *F.P.C.* v. *Southern California Edison Co.* that a sale for resale in interstate commerce was subject to its regulatory jurisdiction, *per se*, and there was no necessity of weighing the national versus local concern involved in the particular sale (see Brief for the Federal Power Commission, *F.P.C.* v. *Southern California Edison Co.*, No. 71, October Term, 1963).

Petitioners seek to becloud the precise issue with a contention that if the Commission is not here given authority to regulate the Lo-Vaca and Houston sales the prices charged will affect El Paso's costs which, in turn, since El Paso is an interstate pipeline company making sales for resale in interstate commerce, may affect ultimate consumers (F.P.C. Br. p. 25; Cal. Br. p. 31; S. Cal. Co. Br. p. 8). The short answer, of course, is that Commission jurisdiction does not turn upon the effect of a transaction upon an interstate pipeline company. Jurisdiction is dependent upon the "bright line" between sales for resale in interstate commerce and direct sales whether in intrastate or in interstate commerce.

Furthermore, the cost of the restricted-use gas would be a cost of fuel just as if Lo-Vaca and Houston were to sell fuel oil to El Paso for use in its compressors. Obviously, the cost of fuel oil would affect El Paso's cost of service. But this would not give rise to Commission jurisdiction over the sale of fuel oil. Simply because the fuel happens to be gas instead of oil changes nothing.

The Commission, in its brief raises a spectre of dire results which it argues might occur if it is not given jurisdiction over the Lo-Vaca and Houston sales (F.P.C. Br. 23-24). Since the limits of Commission jurisdiction are fixed by the Natural Gas Act, the Commission's argument as to the effect of nonjurisdictional transactions is, of course, irrelevant. The Commission does not gain jurisdiction based upon the effect of a nonjurisdictional transaction upon interstate commerce. The *Shreveport* doctrine,[18] which measures the

[18] *Houston, East & West Texas Railway Co. v. United States*, 234 U.S. 342 (1914).

scope of federal jurisdiction under the Commerce Clause[19] based upon a determination whether a transaction affects interstate commerce, forms no part of the foundation for Commission authority under the Natural Gas Act.

Neither can the Lo-Vaca and Houston sales have any effect upon the Commission's area price policy relating to producer rates. Lo-Vaca and Houston are not producers and their sales would not be considered as such, *cf., Ben Bolt Gathering Co.* v. *F.P.C.*, 323 F.2d 610 (5th Cir. 1963).

On the other hand it is apparent that the Commission has adequate power with respect to the operations here involved to protect the public interest in the manner envisioned by the Natural Gas Act. At many points the Commission can exert regulatory control. Thus, all the producer sales to Lo-Vaca will be sales for resale in interstate commerce and therefore subject to certification by the Commission under Section 7. Furthermore, the construction and operation of the Lo-Vaca facilities used to bring the restricted-use gas to the Coquat Station must be certificated by the Commission. In this sense, Lo-Vaca would be in a position somewhat analogous to Transcontinental Gas Pipe Line Corporation which sought authorization to transport gas from Texas to New York for Consolidated Edison Company. See, *F.P.C.* v. *Transcontinental Gas Pipe Line Corporation*, 365 U.S. 1 (1961).[20]

[19] United States Constitution, Article I, Section 8, Clause 3.

[20] In the *Transcontinental* case, however, the producer sales to Consolidated Edison, being direct sales in interstate commerce for the purchaser's own consumption, were not subject to regulation by the Commission. (365 U.S. 1, at 4).

Moreover, in accordance with Commission practice Lo-Vaca will present a feasibility study in support of its application for construction and operation of its facilities and in support of its unrestricted-use sale which will justify the spread between the producers' approved prices and the sales price to El Paso under the jurisdictional sale. It will also demonstrate that its transportation of restricted-use gas is in the public interest.

The Commission can exercise its authority at an additional stage—certification in Docket No. CP60-101 of the 227 miles of pipeline from Three Rivers to Sonora to be constructed by El Paso Gas Supply Company. Other facilities, such as those involved in El Paso's Docket No. G-18616, would also be subject to Commission scrutiny.

Clearly, the Commission has the authority now to protect the public interest in the manner proposed by the Natural Gas Act. The Commission's authority over sales should not be broadened to include the Lo-Vaca and Houston restricted-use sales.

## CONCLUSION

For the foregoing reasons, Respondents request that the decision of the Court below be affirmed.

Respectfully submitted,

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